CALIFORNIA GAMBLING CONTROL COMMISSION
LEGAL DIVISION MEMORANDUM

Public Legal Memorandum

Date: October 1, 2008

To: Terresa A. Ciau, Executive Director

Copy: Commissioners

From: Evelyn M. Matteucci, Chief Counsel

Subject: Explanatory Summary of Proposed Changes to CGCC-8 Minimum Internal Control Standards (MICS) (Amended Form Dated October 1, 2008) to be Considered at the October 14, 2008 Meeting

Summary:

The Association of Tribal and State Gaming Regulators (Association) disapproved CGCC-8 at its meeting of September 4, 2008. The motion stated that the disapproval was based on the Association Task Force Report dated February 13, 2008.[1] Per Compact section 8.4.1(b), the Commission must prepare a detailed, written Response to the Association's objections to CGCC-8. Such as a Response was prepared earlier this year, in a document dated April 23, 2008. An Updated Response to the Association objections will be provided in a separate document to be issued shortly. This Explanatory Summary of Proposed Changes is not the Updated Response.[2]

In response to the many comments received and in recognition of its government-to-government relationship with the Tribes and in the interests of government-to-government cooperation, the California Gambling Control Commission (CGCC or Commission) staff has reviewed all the letters and comments received and undertaken a comprehensive review of the text of CGCC-8, giving special attention to any provision which is even arguably inconsistent with or not authorized by the Compact. CGCC staff also recognized that there was the need for some technical adjustments and other revisions. To that end, the CGCC-8 March 13, 2008 proposed regulation has been amended. The following explains the revisions and corrections

[1] The complete title of the Task Force Report is "Association Regulatory Standards Taskforce Final Report Statement of Need re: CGCC-8 February 13, 2008."

[2] Staff is also preparing another document which will summarize and respond to all oral and written comments concerning CGCC-8, including comments made in letters sent to the Commission after the September 4, 2008 Association meeting.

which seek to clarify, improve, and update the Commission's original regulation. CGCC staff is recommending these changes to the Commissioners for consideration at the October 14, 2008 meeting.

Many Tribal comments assert that adoption of CGCC-8 exceeds the authority granted the State Gaming Agency (SGA) in the Compact. Other comments state that CGCC-8 infringes upon tribal sovereignty. Similarly, given the fundamental disagreement on the scope of SGA authority under the Compact to adopt a Minimum Internal Control Standards regulation, CGCC staff has endeavored to ensure that CGCC-8 is drawn as narrowly as possible, while still protecting the integrity of tribal gaming.

Comments have also been received to the effect that the oversight provisions of CGCC-8 are not clear or not sufficiently detailed. In light of these comments, CGCC staff has undertaken a line-by-line review of the text of CGCC-8, ensuring that the provisions are sufficiently specific.

These changes, if adopted by the Commission, do not need to be sent back to the Association for comment. Compact section 8.4.1(b) authorizes the Commission to re-adopt CGCC-8 following Association disapproval in "its original or amended form, with a detailed, written response to the Associations objections."[3] Per section 8.4.1(c) of the Compact, the amended CGCC-8, if adopted, will go to each Tribe for a 30-day review and comment period.. This post-adoption procedure provides adequate notice of the changes to the Tribes.

Discussion

All references are to the October 1, 2008 amended version.

1. Subsection (a) (Purpose):

Subsection (a) has been divided into four numbered paragraphs to make it easier to read. Also, responding to comments from the Department of Justice, we have added language to paragraph (1) making clear which sections of the Compact authorize the State to conduct compliance reviews and which sections require tribal regulations concerning internal controls.

In paragraph (2), we clarify that CGCC-8 is setting out minimum standards for internal controls "pursuant to Compact Section 8.4."

In paragraph (4), a nonsubstantive change has been made to correct an awkward phrase.

2. Subsection (b) (Internal Control Standards):

In subsection (b), there are several proposed changes to the first sentence. In the original regulation we use the phrase "operation and support" of Class III gaming. We deleted "and

[3]We believe that section 8.4.1, subsection (b) provides a clear exception to the general proposition in subsection (a) of 8.4.1 that the regulation has to be approved by the Tribal-State Association. This readoption and response procedure constitutes a clear exception to the general requirement that the Association approve a regulation before it may be effective. Any other interpretation would render subdivision (b) mere surplusage, and such a construction must be avoided. (*Boghos v. Certain Underwriters at Lloyd's of London* (2005) 36 Cal.4th 495.)

support” because that term is vague and may be read as encompassing matters beyond the scope of the incorporated National Indian Gaming Commission (NIGC) MICS, which only uses the term “gaming operations.” We also revised the sentence to avoid the suggestion that the Tribal Gaming Agency (TGA) is conducting Class III gaming activities; the Tribe is conducting these activities. This also conforms to the language used in the Compact (section 2.4) which uses the phrase “gaming activities,” rather than “gaming.”

Finally, the original text indicated that we were adopting the federal MICS "as may be amended from time-to-time." Use of this phrase is inconsistent with our earlier use of the phrase in the same subsection “as in effect on October 1, 2006”, which was intended to incorporate the NIGC regulations as they stood prior to the judicial decision invalidating them.

Additionally, this “as amended from time to time” language creates a due process/unlawful delegation process problem. This kind of language is routinely rejected in an Administrative Procedure Act regulation. The regulation standard needs to be set at a date certain, otherwise it is a moving target for those required to follow it. It is not fair to require Tribes to conform to future standards without giving them an opportunity to comment on these standards before they are required to comply with them.

Further, if we left the language as is, the federal MICS regulations could be (1) repealed entirely, leaving the State with no standards; (2) could be amended to eliminate most of the protections, thus failing to protect the integrity of gaming or (3) could be amended so that they were overly restrictive and thus prevented tribal gaming operations from operating effectively. Although we had earlier agreed to this as an acceptable change to CGCC-8, upon reconsideration, we deleted the words “as may be amended from time to time,” for the reasons outlined above.

The last change we made to subsection (b) was to delete the requirement that each Tribe provide to CGCC a copy of these standards within 30 days of the effective date of the regulation and all amendments within 30 days of adoption. In place of this requirement, we propose that, following NIGC procedures, that each Tribe provide a copy of these standards and amendments upon request of the SGAs. Additionally, we added that the provision of such copies to the SGA is in accordance with Compact section 7.4.

3. Subsection (c) (Internal Control System):

This subsection is amended to make clear that the Tribe is responsible for ensuring that its “Gaming Operation” has a system of internal controls that complies with the TGA minimum internal control standards. We deleted the word “support” and add the word “activities” for the reasons outlined in item 2, above. The word “operation” is deleted as unnecessary.

3. Subsection (e) (Financial Statements Audit):

We deleted the word “support” and added the word “activities” for the reasons outlined in item 2, above.

4. Subsection (g) (State gaming Agency Access to Records):

We deleted the word “support” and added the word “activities” for the reasons outlined in item 2, above.

5. Subsection (h) (CGCC Review of Independent Audits):

We deleted the word “support” and added the word “activities” for the reasons outlined in item 2, above.

The language in the provision that is of greatest concern is “The compliance reviews **authorized** by this regulation.”

The reference in subsection (h) to compliance reviews being "authorized" by CGCC-8 (rather than the Compact) could arguably invite an argument of “assumption of authority and therefore a compact amendment.” A regulation that "authorizes" the Commission to do anything could be read to support the contention that the regulation is an attempt to amend the Compacts. As that is not the intent of the regulation, the language was changed.

We deleted the word “authorized,” replacing it with the phrase “Nothing in this subsection shall be construed . . .”.

Per the request of several Tribes,[4] we deleted the word “full” from the phrase “full financial audit.” The tribal concern is apparently that the Commission is not authorized to conduct an audit equivalent to a section 8.1.8 audit. We agree with the substance of the concern: the audit referred to compact section 8.1.8 is to be conducted by an independent CPA retained by the Tribe. The role of CGCC staff as to the section 8.1.8 audit is to *review and evaluate* that earlier CPA audit and other information necessary to ensure compliance with the Compact, not to conduct a second audit of the Gaming Operation. Accordingly, the word “full” was deleted.

6. Subsections (i) (CGCC Report Acceptance and Tribal Action Plan) and (j) (CGCC Compliance Review Report Dispute): (See item 8 below for other issues with subsection (j) in conjunction with (n).)

Ralph LePera, an attorney representing Bishop Paiute, sent in a letter in May 2008 making a valid and constructive comment.

Mr. LePera noted that:

> “Subsection (i) states that when on-site compliance review is conducted, the ‘Tribe shall have sixty days . . . to respond to the CGCC draft report.’ This appears to mean that all responses, whether accepting or rejecting the report, need to be received within 60 days. However, subsection (j) as written causes some confusion. Subsection (j) states

[4] This was a request from Jane Zerbi, representing United Auburn Indian Community, at the Association meeting in May 2008, and although not voted on by the delegates at the Association meeting, it seemed to be the consensus of the delegates and there was no opposition when the request was made at the meeting. (The protocol under section C (2)(d) provides that if the SGA amends the regulation in a manner not inconsistent with a majority of the delegates, the Initial meeting requirement will be deemed satisfied.)

'If, after a 60 day review, the Tribe contests the draft report . . . .' This seems to contradict subsection (i) which says that all responses must be made within 60 days. Is subsection (j) an exception to the 60 day rule set out in (i)?"

Mr. LePera also commented that the second line of subsection (j) states:

"'Upon notice by the Tribe of a disagreement and failure to resolve differences, the CGCC staff will finalize and deliver the report.' What if the Tribe never gives notice of a disagreement and failure to resolve differences? Does this mean that as long as the Tribe does not formally provide a notice of disagreement and failure to resolve differences that the report will be in so-called limbo?"

We corrected this confusion and clarified the process by revising subsection (i) and (j). For example, we tried to more clearly distinguish between the *draft* Compliance Review Report and the *final* Compliance Review Report, in subsections (i) (1) and (2).

7. Subsection (l) (Variance To Internal Control Standards):

The variance process in subsection (l) of the original proposal could be read as purporting to grant a power and role to the Commission that arguably is outside the scope of a section 8.4 regulation under the Compacts and more appropriately the subject of a compact amendment. Accordingly, the language was changed to clarify that the Commission agrees a variance process is appropriate even though NIGC no longer has MICS authority and that the review and dispute resolution process regarding variances that a tribe may take advantage of before invoking the compact section 9 process is voluntary. We think the suggested changes will address any concerns that the regulation might be construed as an unauthorized expansion of Commission authority.

8. Subsections (j) (CGCC Compliance Review Report Dispute) and (n) (Disputes):

Subsections ((j) and (n)) contain dispute resolution processes which could conceivably be read in either of two ways:

(1) as arguably outside the scope of Section 8.4 and thus more properly the subject of a compact amendment in that they impose a separate process prior to invoking Compact Section 9.0, or

(2) merely offering an alternative to Section 9.0.

The changes made will address those concerns by clarifying that the Tribe has the <u>option</u> of seeking review by the full Commission before invoking the compact dispute resolution process.

9. Subsection (n) (Disputes):

In addition to the changes discussed above (item 8), the following changes to subsection (n) are recommended. To permit easier reading, subsection (n), following an introductory provision, has been divided into paragraphs (1) and (2), and paragraph (1) has been divided into subparagraphs (A), (B), and (C). These format and content changes were needed,

following the decision (see item 8, above) to offer Tribes the option of seeking review by the full Commission as opposed to the prior wording which could be read to mandate that Tribes seek review by the full Commission prior to invoking the dispute resolution process outlined in Compact section 9.0. While it may well frequently prove advantageous for a Tribe to seek full Commission review before invoking the dispute resolution process, it must be made clear that seeking such review is purely discretionary on the part of the Tribe.

In subparagraph (C) of paragraph (1) of section (n), we have transferred language from the original paragraph (4) making clear that the state retains the right to invoke dispute resolution in the event that the tribe opts for CGCC review, but then declines to abide by the CGCC decision.

Former paragraph (4) has been rewritten and renumbered as paragraph (2) to make clear that either party may invoke dispute resolution in the event that the Tribe does not opt for review by the full Commission.

10. Subsection (o) (Severability):

In anticipation that there may be an argument that not only is the Commission without authority to adopt CGCC, but also that specific provisions are fatally flawed, we have added a severability subsection. The purpose of a severability clause is to permit other provisions of the regulation to continue in effect even though one particular provision is found by a judge to have a fatal defect. (See also Compact section 8.4.1(e) (Tribe may seek “repeal or amendment” of an adopted uniform regulation.).)